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Supreme Court
JUN 15 2005
OFFICE OF THE CLERK

No. 04-1375

In the Supreme Court of the United States

SAMUEL GLAZER,

Petitioner,

v.

LEHMAN BROTHERS, INC., ET AL.,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

RESPONDENT LEHMAN BROTHERS, INC.'S BRIEF IN OPPOSITION

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RULE 29.6 CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, Respondent Lehman Brothers Inc. states that it is a wholly-owned subsidiary of Lehman Brothers Holdings Inc., a publicly-owned corporation.

TABLE OF CONTENTS

QUESTIONS PRESENTED 1

STATEMENT OF THE CASE 1

REASONS FOR DENYING THE PETITION 4

I. This Case Does Not Present A Conflict Among The Circuits 4

II. Applying The Parol Evidence Rule Does Not "Render Prima Paint A Nullity." 6

III. The Court Of Appeals Correctly Ruled That An Arbitration Clause Is Not A "Separate Contract." 8

CONCLUSION 10

TABLE OF AUTHORITIES

CASES

Burden v. Check Into Cash of Kentucky,
267 F.3d 483 (6th Cir. 2001), *cert. denied*,
535 U.S. 970 (2002) 5-6

Galmish v. Cicchini, 90 Ohio St. 3d 22,
734 N.E.2d 782 (2000) 4

Mid-America Acceptance Co. v. Lightle,
63 Ohio App. 3d 590, 579 N.E.2d 721
(10th Dist. 1989) 4-5

Nilavar v. Osborn, 127 Ohio App. 3d 1,
711 N.E.2d 726 (2d Dist. 1998) 5

Perry v. Thomas, 482 U.S. 483 (1987) 7

*Prima Paint Corp. v. Flood & Conklin Manufacturing.
Co.*, 388 U.S. 395 (1967) 3, 5-9

*Sphere Drake Insurance Ltd. v. All American Insurance
Co.*, 256 F.3d 587 (7th Cir. 2001) 6

*Wilson Electrical Contractors, Inc. v. Minnotte
Contracting Corp.*, 878 F.2d 167 (6th Cir. 1989) . . 9

RESPONDENT LEHMAN BROTHERS INC.'S BRIEF IN OPPOSITION

QUESTIONS PRESENTED

1. Was the court of appeals correct in holding that the question of whether certain account agreements were invalid because of a broker's fraudulent intent was an issue for the arbitrator, not the court, under the *Prima Paint* doctrine?

2. Was the court of appeals correct in holding that an arbitration clause that is part of an integrated written account agreement is not a "separate and distinct contract" and therefore Ohio's parol evidence rule precludes reliance on an alleged oral promise that the arbitration clause would not be enforced?

STATEMENT OF THE CASE

Petitioner Glazer opened several brokerage accounts with Respondent SG Cowen Securities Corp. ("SG Cowen") through an SG Cowen broker, Frank Gruttadauria, who was manager of SG Cowen's Cleveland office. When opening these accounts, Petitioner's attorney and financial advisor, Terrance McHugh, returned each of the account agreements at issue signed by Petitioner with no proposed modifications of any kind. Respondent Lehman later acquired SG Cowen's Cleveland business, including Mr. Glazer's accounts and account agreements, and Mr. Gruttadauria continued as manager of the Cleveland office. Both while at SG Cowen and later with Lehman, Mr. Gruttadauria pursued a fraudulent scheme involving the generation of falsely inflated account statements and misappropriation of funds from customers' accounts to keep the scheme going. Petitioner sued SG

Cowen and Lehman, asserting claims for the inflated amounts reflected on the false account statements. Respondents moved to compel arbitration under the broad arbitration clauses contained in each of the account agreements. Pet. App. 4-5.

In a ruling applicable to a number of similar claims, including Mr. Glazer's, the district court held that the arbitration clauses were unenforceable because Mr. Gruttadauria's fraudulent intent at the time the account agreements were executed prevented a meeting of the minds and hence there were no account agreements. *Fazio v. Lehman Bros. Inc.*, 268 F. Supp. 2d 865, 869 (N.D. Ohio 2002), Pet. App. 78. As an alternative ground for refusing arbitration, the district court held that the arbitration clauses could not have been intended to apply to disputes arising out of conduct that amounted to theft. Pet. App. 85.

The court of appeals rejected both grounds. *Fazio v. Lehman Bros. Inc.*, 340 F.3d 386 (6th Cir. 2003), Pet. App. 32. It held that only claims of fraudulent inducement of the arbitration clause itself could be decided by the court, and that claims involving the validity of the contract as a whole must be left to the arbitrators. Pet. App. 39, 42. It also held that the claims were within the scope of the arbitration clauses because they arose out of activities contemplated by the account agreements. Pet. App. 43. The court of appeals remanded all the cases, including Mr. Glazer's, for consideration of any individual issues bearing on the validity of the arbitration clauses, "analyzed independently from the account agreements." Pet. App. 48.

On the remand of Mr. Glazer's case, the district court again refused to order arbitration. *Glazer v. Lehman Bros. Inc.*, No. 1:02 CV 370 (N.D. Ohio Oct. 3, 2003), Pet. App.

49. With respect to the arbitration clauses in four of the five account agreements, the court found that Mr. Gruttadauria had made contemporaneous oral promises to Mr. Glazer that the arbitration clauses would not be enforced. Pet. App. 67. Although the Ohio parol evidence rule precludes varying specific terms of a written agreement by resort to such an oral promise, the court concluded that under *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), the arbitration clauses in the account agreements should be interpreted as "separate and distinct" contracts. Pet. App. 61-62. The court's "separate and distinct" theory was essential to its application of the "sham agreement" exception to the parol evidence rule, which has never been held to apply to only one clause of an integrated agreement.

The court of appeals rejected that reasoning. *Glazer v. Lehman Bros. Inc.*, 394 F.3d 444 (6th Cir. 2005), Pet. App. 1. It held that arbitration clauses are not separate and distinct contracts, but rather that such clauses must be separately considered to determine whether they have been fraudulently induced apart from the contract. Pet. App. 13-14. Consequently, the "sham agreement" exception to the parol evidence rule did not apply, and the parol evidence rule barred proof of contemporaneous oral agreements contradicting a single provision of the executed written agreements. The court also stressed that the strong federal policy favoring arbitration reinforced the conclusions it reached. Pet. App. 15.

Since the parol evidence rule required rejection of the only evidence supporting the district court's finding of fraudulent inducement of the arbitration clauses, the court of appeals held that the district court should have stayed the case until the arbitration process was completed. Pet. App. 28.

REASONS FOR DENYING THE PETITION

I. This Case Does Not Present A Conflict Among The Circuits.

In his attempt to pose a conflict among the circuits, Petitioner relies on an inaccurate characterization of the issue decided by the court of appeals in its initial *Fazio* opinion. Petitioner characterizes the opinion as requiring that an arbitrator decide his challenge to the validity of the contracts at issue, notwithstanding his contention that these contracts were "void," and not merely "voidable."

The argument, however, is based entirely on the label Petitioner attaches to his claim of invalidity. It does not reflect the substance of the claim, which is that the account agreements are invalid in their entirety because of Mr. Gruttadauria's alleged undisclosed intention to defraud Mr. Glazer. No matter how Mr. Glazer characterizes it, the claim is quintessentially one of fraudulent inducement regarding each of the contracts as a whole – that Mr. Gruttadauria entered each agreement with no intention of performing under it. *See Galmish v. Cicchini*, 90 Ohio St. 3d 22, 30, 734 N.E.2d 782, 791 (2000) ("The essence of Galmish's fraudulent inducement claim is that Cicchini harbored this [fraudulent] intent at the time he executed the written agreement and, therefore, made a promise with intent not to perform."). Even assuming plaintiff's factual allegations are true, therefore, the agreements were not "void" but only "voidable" because they were allegedly fraudulently induced. *See, e.g., Mid-America Acceptance Co. v. Lightle*, 63 Ohio App. 3d 590, 599, 579 N.E.2d 721, 727 (10th Dist. 1989) ("a party who has been fraudulently induced to enter into a

contract has the option of rescinding the contract or retaining the contract . . . In other words, the contract is voidable at the option of the defrauded party."); *see also Nilavar v. Osborn*, 127 Ohio App. 3d 1, 12-13, 711 N.E.2d 726, 733 (2d Dist. 1998) ("Secretly held, unexpressed intent is not relevant to whether a contract is formed.").

Because Mr. Glazer's claim is one of fraudulent inducement, it is exactly the kind of claim of invalidity that this Court held in *Prima Paint* must be left to the arbitrator to decide. 388 U.S. at 402-04. It was undisputed that Mr. Glazer executed the agreements and that Mr. Gruttadauria was authorized to execute them on behalf of SG Cowen. The only alleged basis for invalidating them was Mr. Gruttadauria's fraudulent intent. The court of appeals properly applied *Prima Paint* by holding that such claims must be left to arbitration unless the claimed fraud was directed to the arbitration clause itself. Pet. App. 38. A plaintiff may not avoid *Prima Paint* merely by calling the contract "void, not merely voidable."

Petitioner cites no case from another circuit that he contends is in conflict with the decision in this case. Rather, he attempts to find a conflict between decisions in other circuits and the Sixth Circuit's decision in a different case (*Burden v. Check Into Cash of Kentucky*, 267 F.3d 483 (6th Cir. 2001), *cert. denied,* 535 U.S. 970 (2002)), on which the court relied in deciding the present case. *See* Pet. 14-19. In the *Burden* case, the court rejected a claim that the contract containing an arbitration clause was "void" where that claim was based on the fact that the other party lacked a required license. However, the court recognized that a different question would be presented in cases where there is "no contract" because of a forged signature or a lack of signatory

power. *See* 267 F.3d at 489 (referring approvingly to *Sphere Drake Ins. Ltd. v. All Am. Ins. Co.*, 256 F.3d 587, 591 (7th Cir. 2001)). Some, perhaps most, of the federal cases cited by Petitioner as recognizing claims of "voidness *ab initio*" involved lack of signatory power, as in *Sphere Drake*. *See* Pet. 19-23. Thus, it is not apparent in what respect the Sixth Circuit's understanding of the *Prima Paint* doctrine as expressed in *Burden* differs from that of other circuits. Indeed, this Court has already denied certiorari in the *Burden* case itself and there is no reason why the *Burden* decision should be the basis for granting certiorari in this case. Whatever the merits of the *Burden* decision, the initial *Fazio* decision was plainly required by this Court's decision in *Prima Paint*.

II. Applying The Parol Evidence Rule Does Not "Render *Prima Paint* A Nullity."

Petitioner contends that the effect of the second decision of the court of appeals, applying the parol evidence rule, is to nullify the *Prima Paint* decision by making it impossible ever to prove fraudulent inducement of an arbitration clause. The contention is plainly incorrect. The Ohio parol evidence rule does not preclude proof of fraudulent inducement consisting of misrepresentations that do not contradict very the terms of the written agreement itself. The court of appeals' opinion was explicit on this point: "[U]nder Ohio law 'the parol evidence rule does not prohibit a party from introducing parol or extrinsic evidence for the purpose of proving fraudulent inducement.'" Pet. App. 20. But the parol evidence rule "may not be side-stepped by 'a fraudulent inducement claim which alleges that the inducement to sign the writing was a promise, the terms of which are directly contradicted by the signed writing.'" Pet. App. 21-22.

Thus, if assent to an arbitration clause was induced by, for instance, misrepresentations as to how the arbitration process works, or as to the frequency with which arbitrators decide in favor of investors, the parol evidence rule would not exclude such grounds for invalidating the arbitration clause.

Petitioner's point seems to be that the apparent dearth of cases permitting evidence of such extrinsic fraud shows that the parol evidence rule "realistically" bars proof of fraudulent inducement in all but a few cases. Pet. 24. Petitioner therefore asks this Court to "breathe life" into the "defense" allegedly created by *Prima Paint*, by holding that the state-law rule is overridden. Pet. 25-26.

The argument misconstrues the meaning of the *Prima Paint* decision. The decision did not "create a defense" but simply recognized that arbitration cannot properly be ordered if there is no binding arbitration clause. In the language of the Federal Arbitration Act, "[i]f the making of the arbitration agreement . . . be in issue, the court shall proceed summarily to the trial thereof." *See Prima Paint*, 388 U.S. at 404 n. 11. Although the Court had no occasion in *Prima Paint* to discuss the substantive law applicable in determining whether an arbitration clause is invalid because of fraud in its inducement, its subsequent decision in *Perry v. Thomas,* 482 U.S. 483 (1987), made clear that state law "concerning the validity, revocability, and enforceability of contracts generally" is applicable in the enforcement of the Federal Arbitration Act. *See id.* at 492 n. 9. Petitioner presents no substantial reason for departing from that principle in this case. The Sixth Circuit thus did not err in following the Ohio parol evidence rule.

Petitioner's argument that the Court should "breathe life into" claims of fraudulent inducement of arbitration agreements runs directly counter to the objective of the *Prima Paint* decision, which was not to create new ways of avoiding or delaying arbitration but to implement the "unmistakably clear congressional purpose that the arbitration procedure . . . be speedy and not subject to delay and obstruction in the courts." *Prima Paint*, 388 U.S. at 404.

It was undisputed that Mr. Glazer signed account agreements containing arbitration provisions and forwarded these agreements through his lawyer with no modifications to the arbitration clause. To now allow him to escape arbitration by claiming that he was told that the written arbitration clauses would not be enforced contravenes the parol evidence rule as applied in Ohio and elsewhere, and thereby undercuts the enforceability of contracts. Nothing in *Prima Paint* mandates such a result.

III. The Court Of Appeals Correctly Ruled That An Arbitration Clause Is Not A "Separate Contract."

Petitioner argues that the court of appeals "inconsistently" applied the "separability" principle of *Prima Paint* in its first and second opinions in this case. Pet. 27-28. There was no inconsistency, however. In its first opinion, the court adhered to the requirement of *Prima Paint* that a court cannot consider the defense of fraudulent inducement unless the alleged fraud was directed to the arbitration clause, separately considered. Pet. App. 40-41. In its second opinion, the court correctly concluded that this requirement did not mean that the arbitration clause is a "separate contract" for all purposes. Pet. App. 14-17. If that were the case, as the court noted, it would mean that there must be separate "consideration" for

the arbitration clause and separate satisfaction of all the other elements of a binding contract – a conclusion that had been rejected by the Sixth Circuit's own prior decision in *Wilson Electric Contractors, Inc. v. Minnotte Contracting Corp.*, 878 F.2d 167 (1989), and similar decisions in other circuits. Pet. App. 16. The court's conclusion was correct. To read such a "separate contract" requirement into the *Prima Paint* decision would only undermine the effect of that decision by creating novel grounds for avoiding arbitration. No such purpose can be found in the language or rationale of this Court's decision in that case.

The entire purpose of Petitioner's effort to treat the arbitration clause as a separate contract is to apply the "sham agreement" exception to the parol evidence rule. That exception allows the introduction of parol evidence to show that neither of the parties had any intention of entering into an actual contract. The exception, however, has never been applied to one clause of an integrated contract and to do so here would substantially undercut the enforceability of arbitration clauses by eliminating application of the parol evidence rule to claims that such clauses were fraudulently induced. In effect, arbitration clauses would not be on an equal footing with other contracts because, if Petitioner's position were accepted, written arbitration provisions would not be enforceable whenever one party claimed to have been told that it would not be enforced. Nothing in *Prima Paint* warrants holding that arbitration provisions can be so readily side-stepped.

CONCLUSION

For all of the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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June 15, 2005